



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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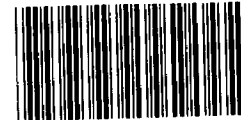
GENERAL GOVERNMENT
DIVISION

B-197162

JANUARY 4, 1980

ABC 505

The Honorable Lawrence Connell
Chairman, National Credit Union
Administration



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Dear Mr. Connell:

Subject: [Internal auditing needs more
support in the National Credit
Union Administration] (GGD-80-31)

We have completed our review of the National Credit Union Administration's (NCUA) internal audit function. We assessed the Office of Internal Audit and Investigation 04603553 against widely accepted professional internal auditing standards formulated for private industry and government.

Internal auditing needs more support in the National Credit Union Administration. Although NCUA has established an internal audit unit with broad review responsibilities, the small size of the unit prevents it from carrying out all its responsibilities. Audit coverage has been sparse, and the need to obtain support from staff detailed from other activities has lengthened audit reporting times and created a potential for compromising audit independence. In addition, the frequent turnover in the leadership of Internal Audit has been disruptive and detrimental to achieving stability and consistency within the unit.

INTERNAL AUDIT HAS AN IMPORTANT ROLE
IN NCUA'S MANAGEMENT CONTROL SYSTEM

NCUA's management control system includes a network of information systems and review groups designed to supply information to policymaking levels where it can be evaluated and acted on. Because of its independence, the Office of Internal Audit and Investigation is in a unique position to play a key role in NCUA's management control system.

The Director of Internal Audit and Investigation reports directly to the Chairman and is responsible for:

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- (1) Conducting independent reviews and appraisals of all NCUA programs and functions to ensure compliance with statutory and regulatory requirements, determine that NCUA operations are conducted efficiently, and ascertain that each NCUA office is achieving its particular mission.
- (2) Performing independent investigations concerning employee grievances, violations of merit promotion procedures, and other matters as directed by the Chairman.

Internal Audit is in a unique position to serve the Board and top management. Because it is organizationally independent, it can perform a particularly valuable function in NCUA's management control system. Internal Audit can assist all levels of NCUA management by evaluating specific programs and operational areas, reporting on problems and deficiencies and recommending solutions. The Chairman can look to Internal Audit for factual and candid appraisals of how the various NCUA organizations carry out their assigned responsibilities. Internal Audit's independent appraisals of NCUA activities will complement the normal operating controls, studies, tests, and research projects which form the core of NCUA's management control system.

INTERNAL AUDIT HAS MADE PROGRESS
TOWARD ESTABLISHING AND MAINTAINING
A PROFESSIONAL INTERNAL AUDIT UNIT

The Office of Internal Audit and Investigation has made progress in establishing its own management control system. In December 1978, Internal Audit issued "Guidelines for Internal Audit and Investigation." This document, which serves as the unit's audit manual, outlines the objectives of internal audit at NCUA, the policies to be followed, the general scope of work to be performed, the standards of performance, and the reporting requirements.

Our review of Internal Audit's operating practices indicated that

- written audit programs consistently include certain essential elements: objectives and scope of the audit, background information, audit procedures, and reporting procedures;
- audit evidence adequately supports findings and conclusions;

- written audit reports effectively communicate findings, conclusions, and recommendations to both the auditee and top management; and
- auditees respond in writing to audit reports within a specified period, after which Internal Audit reviews and comments on their responses.

SEVERAL KEY FACTORS HAVE LIMITED
INTERNAL AUDIT'S EFFECTIVENESS

Although NCUA top management has established an internal audit function with important management control responsibilities, other top management actions have contributed to reducing Internal Audit's ability to meet these responsibilities. Since 1975, the size of the Internal Audit staff has been held to three professionals. This constraint has led to incomplete audit coverage and places limitations on Internal Audit's ability to effectively audit computer systems. In addition, the staffing limitations have forced Internal Audit to rely on staff detailed from other offices to help conduct audits, which, in turn, has contributed to lengthening audit reporting times and limiting staffing flexibility, due to potential impairments of Internal Audit's independence. Also, in the last 6 years the head of Internal Audit has been changed four times, thereby adversely affecting Internal Audit's operating consistency.

Permanent staff size should be increased
to provide better audit coverage

Internal Audit's staff size has been limited to three permanent auditors since 1975, even though the unit's responsibilities have increased and the agency has grown. As a result, important areas of agency activities are receiving little or no audit attention.

The effectiveness of any management activity is directly related to the quality and the quantity of the resources committed to it. As the nature and extent of an activity are changed, the level of resources devoted to the activity should be reevaluated to ensure that a proper degree of emphasis is maintained.

From 1973 through 1975, NCUA maintained a nominal internal audit unit with very limited review responsibilities. In 1973, when the Office of Inspection and Audit was established, its authority was limited only to audits of the six regional offices. These reviews were primarily compliance audits. At

that time, with 498 employees and expenses of \$8.7 million, NCUA had set up an internal audit unit consisting of only an Assistant Administrator for Inspection and Audit and a secretary. The Assistant Administrator was required to borrow staff from other NCUA organizations to meet his audit responsibilities. In 1975, two program analysts were added to the unit, but other NCUA staff were still needed to conduct audits.

Since 1975, however, Internal Audit has had three major increases in its responsibilities. In March 1976, Internal Audit's authority was expanded to include an annual financial audit of NCUA. In June 1977, Internal Audit's authority was further expanded to include investigations and periodic audits of NCUA's Washington, D.C., offices. Finally, in 1979, Internal Audit's authority was again expanded to include audits of the new Central Liquidity Facility. The Financial Institution Regulatory and Interest Rate Control Act of 1978 required the establishment of a Central Liquidity Facility as a lender of last resort to credit unions. The Central Liquidity Facility's by-laws provide for regular audits of its functions by Internal Audit.

In addition to expanding Internal Audit's responsibilities, the agency has grown since 1975. During the 1975-1979 period, NCUA experienced a 9.4-percent increase in permanent positions (from 584 to 639), a 157-percent increase in annual expense levels (from \$10.2 million to \$26.2 million), and the introduction of 6 new organizational units into its structure.

While NCUA grew and Internal Audit received increased responsibilities, the permanent audit staff (three auditors) remained at the 1975 level. Since 1977, the Director of Internal Audit has requested additional permanent staff for the unit. In responding to his requests, management cited resource constraints as the chief reason for not providing additional resources.

Internal Audit's small staff size has contributed greatly to limiting the scope of audit coverage. Twenty-five assignments were completed from January 1976 through June 1979, as follows:

Assignments Completed By Internal Audit:
January 1976 to July 1979

<u>Year</u>	<u>Regional office audits</u>	<u>Investi- gations</u>	<u>Management opinion surveys</u>	<u>Func- tional audits</u>
1976	5	2	0	1
1977	6	2	1	0
1978	0	2	0	3
1979 (7/30)	0	1	1	1

Investigations usually involve examining the support for allegations or grievances concerning employee rights or misconduct. Management opinion surveys involve the periodic solicitation of employee opinions concerning management effectiveness and certain measures of staff morale. Functional audits, as with regional office audits, are concerned with evaluations for compliance with agency policies by specific functional area.

The small size of the audit staff causes many important areas of NCUA activity to remain unreviewed or only partially reviewed. For example:

- credit union examination and supervision activities,
- chartering activities,
- insurance activities,
- liquidation activities,
- the formulation and monitoring of consumer programs,
and
- NCUA's computer security plan.

These areas include the primary functions of the agency, as well as those with the most employees, greatest expenditure of funds, and the most difficult asset accountability challenges.

Internal Audit's computer-auditing
capability should be strengthened

Internal Audit has lacked the skills necessary to effectively audit NCUA's computer-based operations. Two recent

outside audits found internal control problems in NCUA's data processing activities. An April 1979 report on NCUA's computer operations by the Office of the Comptroller of the Currency (OCC) and our June 1978 letter report to the NCUA Administrator questioned Internal Audit's ability to effectively audit computer operations. They both stated that the present staff does not have the technical expertise to adequately audit NCUA's computer-based systems and data processing operations. Since October 1977, the head of Internal Audit has requested that a permanent computer auditor be added to the staff. These requests, however, were denied by management, which cited overall agency resource constraints as the reason.

During our audit field work, NCUA management responded to the need for a computer-auditor by agreeing to hire a computer-specialist for a 2-year term. This action, we understand, failed to produce a desirable candidate willing to take the job on a 2-year basis. In October 1979, after completion of our field work, we were advised that NCUA initiated action to hire a full-time computer-specialist.

Internal Audit should rely less on
staff detailed from line management

Since Internal Audit's permanent staff is limited to three professionals (four, if a computer auditor is added), it is forced to rely heavily on staff detailed from other offices to carry out its audit responsibilities. The use of detailed staff, however, lengthens audit timeframes and limits Internal Audit's staffing flexibility by presenting independence problems.

Using staff detailed from other offices
contributes to delays

Using detailed staff contributes to delays in completing audits. The detailed staff, which are typically brought in from regional offices for 2 to 3 weeks at the start of an audit, are normally used to complete various segments of the audit program. These segments generally involve gathering and analyzing information. Detailed staff do not usually participate in report writing.

Professional internal audit standards emphasize the importance of issuing timely audit reports. In order for an audit report to be of maximum use, it should be available, when needed, to appropriate management officials.

While much of the detailed staff's work contributes to audit findings and recommendations, the extent of the contribution is limited by the staff's experience and availability. As a result, the full-time auditor-in-charge frequently has to verify the tentative findings identified by staff who have left. In addition, he must sometimes complete the staff's unfinished audit steps. The auditor-in-charge has also generally been responsible for writing the entire audit report after detailed staff have gone. Because of this staffing arrangement, Internal Audit's last two functional audit reports were not issued until about a year after the initial detailed staff had been released. A third major functional audit, incomplete as of August 1979, also follows this pattern, as shown on the following chart.

<u>Audit</u>	<u>Date audit started</u>	<u>Number of detailed staff involved</u>	<u>Dates of detailed staff involvement</u>	<u>Date report issued</u>
Division of Office Service	11/14/77	3	11/14/77 - a/12/02/77	3/13/79
Division of Personnel	10/31/77	2	11/02/77 - 11/11/77	10/18/78
Office of the Comptroller	4/17/78	6	4/16/78 - 5/05/78	Not com- plete as of 8/31/79

a/The scope of the assignment was subsequently expanded, and one detailed staff person returned from October 10 to November 9, 1978.

As shown on the chart, each audit experienced a long delay from completion of staff work to issuance of the report. Internal Audit attributed these delays to a combination of factors, including:

- The need to continually train new staff in audit techniques, only to lose them with little benefit gained from their experience.
- An inability of the auditor-in-charge to concentrate on writing the audit report due to interruptions for investigations and other special assignments.

- The need to redo field staff work, at times, due to poor quality, or because the time lapse between analysis and reporting rendered the work obsolete.

Using staff detailed from
other offices may compromise
Internal Audit's independence

Internal auditing standards emphasize that, in all matters relating to audit work, the audit organization and the individual auditors must maintain an independent attitude. The auditor should consider not only whether his own attitudes and beliefs permit him to be independent, but also whether there is anything about his situation which would lead others to question his independence. Personal bias is an impairment which can adversely affect an auditor's independence. It involves circumstances in which an auditor may not be impartial because of his personal views or attitude. These circumstances might include

- relationships of an official, professional, and/or personal nature that might cause the auditor to limit the extent or character of inquiry;
- preconceived ideas about the objectives or quality of a particular operation, or personal likes or dislikes of individuals, groups, or the goals of a particular program;
- previous involvement as a decisionmaker or manager in the operation of the entity or program being audited; or
- biases or prejudices which result from employment by or loyalty to a particular group or entity.

Internal audit's primary asset and greatest value lies in its independence. It is essential, if this value is to be protected, that individual auditors not be placed in situations which are, or appear to be, a threat to their objectivity and independence.

Using staff on limited detail from NCUA regional offices to audit activities which they have authority or responsibility for in another region, instead of using permanent staff, creates additional opportunities for preconceived ideas or biases about these activities to influence objectivity. The regional staff assigned to Internal Audit have audited both regional office and headquarters activities. Although

regional staff do not audit within their own regions, they have audited the same functions for which they are responsible in their own region. On two occasions the Chief of Chartering, Insurance and Liquidations in one region audited liquidation functions in other regions.

A potential for bias also exists in having field staff participate in functional audits of headquarters operations. For example, Internal Audit has planned a major audit of the credit union examination function toward the end of 1979. In order to conduct this audit, Internal Audit will need to draw upon field staff for assistance. If the field staff assigned to the audit are examiners, the potential for bias arises because they will be auditing their own organization, the Division of Examinations and Insurance. As a result, Internal Audit's flexibility in assigning detailed auditors will be constrained by the need to avoid potential compromises of independence.

The Director for Internal Audit is aware that using detailed staff has the potential for compromising Internal Audit's independence. Without adequate permanent staff, he has relied on, and must continue to rely on, detailed staff to execute his responsibilities.

Internal Audit's leadership
should be stabilized

Over the last 6 years the Director of the Office of Internal Audit and Investigation has changed four times. As a result, long-range goals and adherence to established procedures, which depend on consistent supervision from senior management, have been very difficult to maintain.

Stability is an essential condition in achieving any effective management system. If the system's personnel, particularly those in leadership roles, are constantly changing, the system's policies, procedures and activities may be seriously disrupted.

Since the establishment of Internal Audit in 1973, four individuals have served as Director. In addition, the present Director plans to retire at the end of 1979. The recent OCC report on data processing activities stated that, with such turnover in the Director position, it is difficult to provide the continuity and guidance necessary to accomplish Internal Audit's goals and objectives within a planned timeframe.

A March 1978 external review of NCUA's compliance with administrative procedures indicated that Internal Audit had not been timely in adjusting to changes in audit standards. For example, Internal Audit had not prepared an annual plan for fiscal year 1978, although it had done so for prior periods. In addition, the report stated that Internal Audit was not in compliance with Federal Management Circular 73-2 and GAO internal audit criteria. The report linked these deficiencies with the fact that Internal Audit had recently undergone a change in leadership. The head of Internal Audit stated that the unit's authority was also greatly expanded in 1977; therefore, it needed more time to develop a plan to cover the new areas.

Under the same leadership for the past 2 years, Internal Audit's compliance with internal audit standards has improved. However, since the current Director plans to retire at the end of 1979, Internal Audit must again face a change in leadership. Another period of adjustment will occur.

CONCLUSION AND RECOMMENDATIONS

We realize that NCUA is a relatively new agency, that internal auditing is a recent activity, and that resources are limited. However, an adequately staffed and vigorous internal audit unit, through its independent approach and review methodology, can contribute greatly to achieving efficient and effective operations.

Accordingly, we recommend that you, as Chairman of NCUA,

- strengthen the support for the Office of Internal Audit and Investigation by providing the unit with the additional staff resources necessary to effectively accomplish its organizational responsibilities, and

- consider the need for a stable leadership structure when replacing the current Office Director.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Chairman, Senate Committee on Banking, Housing and Urban Affairs; the Senate Committee on Appropriations; the Senate Committee on Governmental Affairs; the House Committee on Banking, Finance, and Urban Affairs (Subcommittee on Financial Institutions, Supervision, Regulation, and Insurance); the House Committee on Appropriations; and the House Committee on Government Operations (Subcommittee on Consumer, Commerce, and Monetary Affairs).

Sincerely yours,

A handwritten signature in dark ink, appearing to read "A.R. Voss". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Allen R. Voss
Director